THE FIRST NATIONAL CITY BANK OF NEW YORK

1960

First National City Bank Monthly Letter

Business and Economic Conditions

New York, March 1960

General Business Conditions

THE opening weeks of 1960 have brought the seeming paradox of new records in output and income, with promise of further gains during the spring, and at the same time disappointment that sales and orders in some important lines have not come up to expectations. Such expectations may have been over-optimistic to begin with, but these disappointments, together with the reaction in the stock market, have introduced a note of hesitancy into the buoyant optimism so prevalent after the settlement of the steel strike. Yet the failure of a bigger boom to develop provides ground for longer-range hopes that the record levels of activity that have been reached will prove sustainable.

The tide of production and trade increases has been running strongly. Industrial activity and personal income in January set new records which presumably were matched or exceeded in February. The number of persons at work in January and the amount of money spent in retail stores exceeded any previous January. As elsewhere reported in this *Letter*, corporate earnings are showing a good recovery from the strike-ridden third quarter, and the hope, shared by the Internal Revenue Service, is that they have pushed above the old peaks of 1955-56.

CONTENTS

Great Expectations

Business has been disappointing only against the standard of excessive expectations. Lagging passenger car sales in the early weeks of January led to downward revision of sales estimates for the year. Production schedules, which were involving considerable overtime and Saturday work, have been cut back, as dealer stocks by February 20 had been built up to a near-record 925,000 cars. Including imports, total stocks are well over a million units. Yet at the same time that assembly operations were being reduced, new car sales were picking up encouragingly. In the first 20 days of February, sales were 20 per cent ahead of the corresponding 1959 period. How big the spring selling season will be is still uncertain, but the reception of the new compact cars has been decidedly favorable. These cars, accounting for approximately one quarter of total passenger car output compared with 9 per cent a year ago, are taking some business away from standard size vehicles as well as imports.

Activity in the nation's factories, mines, and utilities in January was the highest on record. The recently revised Federal Reserve index of industrial production (seasonally adjusted, 1947-49=100) hit a new peak of 169 in January, up 14 points or 9 per cent from November and 3 points above the pre-strike high in May and June. Durable goods producers, hurrying to get output and stocks back to more normal levels, staged an explosive recovery and boosted production 17 per cent in two months, while non-durable goods output edged up moderately in January to match the high set last September.

Inventory Rebuilding

Accompanying the revival in durable goods output and shipments in December was a rapid rebuilding of industrial inventories. The book value of durable goods manufacturers' stocks is estimated to have risen $653 million during December, including a large volume of steel as raw material and goods in process. Total business inventories increased $800 million – equivalent to an annual rate of $9.6 billion. A rate of accumulation of this magnitude is not expected to continue. Businessmen are giving close attention to inventory control.

The speed with which stocks are being rebuilt, so soon after the resumption of steel production, indicates that inventory demand may begin to taper off sooner than originally anticipated. The excess of output over consumption – another name for inventory accumulation – is already being whittled down from both directions. In the case of automobiles, the rise in retail sales, on one hand, and the cutbacks in production, on the other, are combining to slow the increase in dealers' stocks and bring inventories under control. Steel mills have also eased operating rates slightly, from 95½ per cent of capacity in December and January to about 94 per cent in February. Leading steel industry officials have predicted continued gradual declines in output during the second and third quarters, although mills have heavy order backlogs and replenishing of steel stocks is still far from complete.

Underlying Strength

The key to the outlook for 1960 lies in the strength of final demand by consumers, business and government. If demand is sluggish, production generally will decline. But if final demand, as widely expected, rises as the year goes along, the anticipated slackening in inventory accumulation need not cause a business downturn. One need look no further back than the previous business cycle to observe that inventory accumulation reached its peak rate in the fourth quarter of 1955; yet gross national product continued to rise through the third quarter of 1957 – nearly two years longer. It is also worth noting that both steel and automobile production declined markedly in 1956 from their 1955 peaks. Yet over-all industrial production, of which these two industries are only a small fraction, rose in 1956 over 1955. In general, the rise in consumer purchases and in business investment in new plant and equipment kept activity rising long after autos and steel passed their peaks. Inventory accumulation did not disappear once it was past its peak, but tapered off gradually.

It will be some time before the relative strength of consumer purchases and business investment in the current cycle becomes clear. Little new information on the prospects for business capital spending has become available since the settlement of the steel dispute and since the recent reaction in the stock market. Thus, it is hard to evaluate what changes these factors have made in businessmen's attitudes toward new investment. However, testimony before the Joint Economic Committee a few weeks ago brought out the fact that appropriations for new capital programs by leading manufacturing corporations were up 45 per cent in the fourth quarter of 1959 compared with a year earlier. These figures were cited by Martin R. Gainsbrugh, of the National Industrial Conference Board, as a basis for believing that the rise in plant and equipment spending would continue into 1961. Favorable indications for profits, and increasing internal generation of corporate funds, will help to stimulate as well as finance the projected rise in capital outlays.

Consumer income was at a new record annual rate of $393 billion in January and is expected to rise further in the months ahead. Not only have recent wage settlements boosted earnings, but U.S. Labor Department officials expect employment to rise more than seasonally over the next few months. Recent consumer surveys have indicated a high degree of optimism among consumers and plans to buy substantially more autos and other durable goods than a year ago. The stabilizing of consumer prices in recent months, largely due to lower food prices, gives promise of record-high real income for the American people in 1960.

Corporate Earnings in 1959

Annual corporation reports for 1959 reflect the vigorous recovery of the national economy from the recession of 1957-58, as well as the benefits obtained from continued heavy capital investment programs. Despite the costly impact of the steel strike, large numbers of companies set new high records in sales and earnings as well as in payrolls, payments for materials and supplies, purchases of services from others, and in taxes paid.

Our tabulation of the statements published to date by 2,404 corporations shows combined net income after taxes of $17.7 billion for 1959, an increase of 20 per cent over the recession year 1958. Sharp increases occurred in the manufacturing industries—particularly in those branches that had experienced serious declines the year before.

Preliminary Summary of Net Income of Leading Corporations for the Years 1958 and 1959

(In Thousands of Dollars)

No. of Cos.	Industrial Groups	Reported Net Income After Taxes 1958	1959	Per Cent Change†
111	Food products	$ 423,025	$ 481,351	+14
34	Beverages	161,755	191,050	+18
13	Tobacco products	221,875	240,746	+ 9
53	Textile products	97,855	193,647	+98
34	Clothing and apparel	18,425	28,767	+56
15	Shoes, leather, etc.	31,685	39,571	+25
23	Tires, rubber, products	207,488	261,996	+26
32	Lumber, wood prod.	103,270	137,844	+33
48	Paper and allied prod.	244,434	294,041	+20
55	Chemical products	779,000	1,030,708	+32
38	Drugs, soap, cosmetics	339,669	383,673	+13
21	Paint and varnish	93,460	116,936	+25
97	Petrol. prod. & ref.	2,317,092	2,630,040	+14
65	Cement, glass, stone	431,562	547,466	+27
42	Iron and steel	777,684	815,969	+ 5
510	Other metal products	1,803,468	2,296,542	+27
53	Automobiles & parts	842,955	1,634,272	+94
43	Other transp. equip.	192,177	166,804	−13
95	Misc. manufacturing	143,386	201,047	+40
1,382	Total manufacturing	9,230,260	11,692,470	+27
13	Metal mining	28,448	33,107	+16
19	Other mining, quarry.	93,202	100,227	+ 8
32	Total mining, quarry.	121,650	133,334	+10
32	Chain stores — food	198,623	209,003	+ 5
44	Chains — variety, etc.	115,089	133,324	+16
54	Department & spec.	123,859	146,139	+18
67	Wholesale and misc.	281,109	329,536	+17
197	Total trade	718,680	818,002	+14
113	Class 1 railroads	603,000	574,000	− 5
52	Other transportation	74,992	93,531	+25
165	Total transportation	677,992	667,531	− 2
162	Elec. power, gas, etc.	1,429,516	1,562,074	+ 9
15	Telephone & telegraph	1,081,012	1,269,342	+17
177	Total public utility	2,510,528	2,831,416	+13
23	Amusements	3,390	36,141	+…
14	Restaurant and hotel	5.437	7,446	+37
42	Other bus. ser. & const.	98,246	100,687	+ 2
79	Total amuse., ser., etc.	107,073	144,274	+35
178	Commercial banks	806,310	800,930	− 1
142	Investment trusts	439,377	498,688	+13
30	Sales finance	131,003	141,126	+ 8
22	Real estate	6,232	10,828	+72
372	Total finance	1,382,972	1,451,572	+ 5
2,404	Grand total	$14,749,155	$17,738,599	+20

† Increases or decreases of under 1% or over 100% not shown.

Most utility systems supplying electric, gas, telephone, and other services maintained their long-term growth in operating revenues and net income, although about one in eight had net earnings squeezed by lagging revenues combined with rising expenses and taxes. Railroads as a whole had a slight dip in net, reflecting traffic losses from the steel strike and higher costs; most airlines realized increases.

In the fields of retail and wholesale trade, reporting companies generally showed gains in dollar sales, with increases in net income outnumbering decreases by four to one.

Trends In Manufacturing

For 1,382 manufacturing corporations reporting to date the composite earnings are up 27 per cent. This is a far cry from the 65 per cent gain recorded last August in our tabulation covering the first half of 1959 but, nevertheless, sufficient to indicate a new high record for profits in manufacturing, surpassing the previous peak in 1956. The last half of 1959 showed a weakening trend in the year-to-year comparisons with 1958 for two principal reasons: the progressive recovery of profits during 1958, and the impact of the steel strike which hurt results in the third and fourth quarters of 1959.

Manufacturers' figures for the fourth quarter, available from 714 companies, show a largely seasonal rebound of 16 per cent from the preceding quarter, but a decline of 11 per cent from the final quarter of 1958. In both comparisons the number of companies having increases exceeded the number with decreases.

Manufacturers' reports for the full year, although frequently pulled down by a poor fourth quarter, realized gains over 1958 by four to one. Manufacturers of automobiles, trucks, and parts made a sharp come-back following their slump in 1958, although last year's earnings of some companies were handicapped by strikes in supplying industries as well as by heavy costs on model changeovers and the introduction of compact cars. Gains predominated in the machinery, appliance, and other metal products industries, even though fourth quarter results also were hurt in many cases by steel shortages or premium prices paid to get steel.

The steel companies themselves, hit by the recession in 1958, were unable to achieve much recovery in the full year 1959 because of strike losses in the second half year. While fourth quarter earnings of the reporting companies contrasted with a net deficit in the third quarter, they fell far short of the fourth quarter of '58.

A majority of reporting companies in the chemical, drug, and cosmetic lines showed increases in earnings, accompanying a substantial growth in sales and capital investment. The petroleum producing and refining group had moderate gains, despite the continued problems of oversupply and depressed prices of refined products. Makers of cement, glass, and stone products benefited from the building boom, and glass was helped also by the recovery in automobile production.

Among the consumer-goods lines, vigorous gains were registered in textiles and apparel, with smaller gains in food products, beverages, tobacco, and shoes.

Noteworthy features of the reports are references again and again to the benefits derived from research and the development of new products, widening of market demand, capital expenditures on plant and equipment, and the im-

provement in operating efficiency by better management and methods. On the less favorable side, however, were comments on the problems of rising cost pressures, particularly from employment costs and taxes.

There was still considerable red ink used last year, though much less than in the year before. Of the 1,382 manufacturing corporations publishing annual reports to date, deficits were incurred in 1958 by 141 totaling $127 million; in 1959 there were 98 reporting deficits totaling $103 million.

Annual reports for a large number of additional companies to be published in March will be included in a final summary in our April issue. As in previous years this will give, by industry groups, the average percentage profit margins on sales or revenues, and the rates of return on book net assets or net worth.

Recovery In Dividend Payments

Reflecting the recovery in corporate net income last year, cash dividend payments increased by 6 per cent to a new high total, according to Department of Commerce computations. Despite the rise, which was widely distributed among the major industries, the relative contribution of dividends to total personal income was about the same as in 1958 – 3.3 per cent. Figures for January 1960 show dividends up 10 per cent over January '59.

A New Douglas Report

It was ten years ago, in January 1950, that a Congressional Joint Economic Subcommittee, under the leadership of Senator Paul Douglas of Illinois, presented an historic Report on *Monetary, Credit and Fiscal Policies* which recommended that the Federal Reserve be freed from responsibility to hold down Treasury borrowing costs and be permitted to pursue "timely flexibility" in monetary policy "even if the cost should prove to be a significant increase in service charges on the Federal debt and a greater inconvenience to the Treasury." Fourteen months later, in March 1951, the Treasury agreed to the "unpegging" of the bond market; in other words, the removal of par supports for 2½ per cent U.S. bonds. In the following two years the Federal Reserve regained full freedom to adjust monetary policies and discount rates to general economic conditions.

Now we have a new Douglas Report, put out by the Joint Economic Committee under the chairmanship of Senator Douglas and on the broader subject of *Employment, Growth and Price Levels.* This Report, the result of a ten-months' study participated in by a number of economists from outside government, covers a much wider compass, as the title suggests, ranging all the way from general monetary and fiscal policies to antitrust, industrial pricing, farm, and balance-of-payments problems. The most general criticism of the Report is that it attempts too much and is unable to deal in depth with the numerous subjects handled.

A Divided Committee

On some notable occasions in the past the Joint Economic Committee has been able to reach agreement on a broad, statesmanlike approach to problems of the day. The 1950 Douglas Report was endorsed by all five of the subcommittee members. The 1960 Report, by way of contrast, is a splintered document. The six Republican members, objecting to the "needlessly partisan" tone of the majority report, signed a separate statement of minority views. Seven Democratic members signed the majority report but three of them entered particularized dissents. Thus, at least in some passages, the majority report evidently reflects a minority viewpoint.

As for the central issue of the earlier Douglas Report, the new Report reconfirms unalterable opposition to Federal Reserve pegging of government security prices. On this the whole Committee was in agreement save for the single dissent of Congressman Patman who has long been an advocate of having the Federal Reserve fix government bond prices. The whole Committee also agreed – as the President has proposed – that the Federal Government should "aim for higher budget surpluses during periods of prosperity" and generally pursue "a much tighter fiscal policy. . . ." Again, there was unanimous agreement on needs for reform of the tax system, particularly of "features which distort and inhibit growth."

The discussion of economic growth, in the main, found the Committee divided on party lines. The majority report categorically stated that "if we pursue policies which will foster growth, the economy could grow at a rate of approximately 4½ per cent a year over the next fifteen years" and have relatively full employment "without creeping or galloping inflation." The minority report, decrying lack of emphasis on the preservation of freedom and opportunity for the citizen, called the 4½ per cent growth rate an illustration of the "numbers racket". It was pointed out that witnesses at the Committee's final sessions at the end of October had warned against setting a target rate of growth.

The Committee divided on many controversial ideas in the majority report. Examples, too numerous to list, included selective credit controls, plans to adjust personal income tax rates up and down to help stabilize the economy, and the concept that inflation is caused by industrial market power.

Basic Reforms and the Bond Rate Limit

The Committee again split down the middle on the much debated removal of the 4¼ per cent Treasury bond rate limit which was set in 1918 in the course of authorizing the Third Liberty Loan. The President initially requested removal of the limit last June. The wisdom of his proposal has been demonstrated by events in the market since then. The Treasury's inability to offer more than 4¼ per cent on bonds due beyond five years has required excessive issues of bills, certificates, and notes due within five years, creating congestion in this sector of the market and forcing the Treasury to pay as much as 5 per cent or even more for short-term money during the past six months. The Treasury has been denied opportunity to carry forward its "advance refunding plan." This would entail offering to holders of bonds still some distance from maturity the opportunity to exchange for longer-term bonds paying higher rates, thus pushing off bond maturities and reducing the dimensions of the refunding problem as time goes along.

On February 23 the House Ways and Means Committee approved a bill which would free advance refundings from the rate ceiling and also permit up to about $5.7 billion a year bond financing without regard to the 4¼ per cent rate limit. While removing the bond rate limit would have been a simpler solution, this formula, if adopted by the Congress, would give the Treasury ample leeway to take advantage of favorable market opportunities to lengthen the debt.

While most members of the Joint Economic Committee recognized "no logical reason for an arbitrary 4¼ per cent ceiling," the majority report under the leadership of Senator Douglas took the position that agreement upon "major and extensive reforms" should be a condition to the removal of the bond rate limit. The proposed reforms range from measures already planned by the Treasury to far-reaching, highly controversial changes, each of which would require major independent study before it could be usefully considered.

The JEC majority agreed that lengthening the public debt at minimum interest cost should be "the fundamental objective of debt management today," and specifically commended advance refunding as "an important means of lengthening the debt." The majority also put forth some proposals of a technical sort which the Treasury has had under study: using the auction method in selling Treasury certificates, notes, and bonds; issuing bonds callable at the option of the Treasury as opposed to long-term fixed maturity issues; and requiring by law margins on U.S. bonds and subjecting government security dealers to "financial requirements."

As examples of some more dubious proposals, the majority suggested the issuance of "savings bonds which are adjusted to changes in the price level." It recommended elimination as a general practice of the ability of banks to borrow from the Federal Reserve Banks, this last representing a challenge to the original concept of the Federal Reserve Banks as bankers for banks and threatening to remove the primary reason banks have for voluntarily affiliating with the Federal Reserve and submitting to the numerous rules and regulations applying to members.

Federal Reserve Bond Buying

The JEC Report has a concept that, if fiscal policy were tighter, less reliance would need to be placed on credit restraints to contain inflationary pressures. While correct in principle, the proposals for relaxing credit policy go so far as to give the majority report a generally inflationary flavor. Unlike the 1950 Douglas Report, the central theme of the 1960 Report is stabilization of interest rates and bond prices and getting Treasury borrowing costs down.

Thus, the JEC majority would also impose "reforms" on the Federal Reserve as a condition to removal of the 4¼ per cent bond rate limit. The majority report is sharply critical of the Federal Reserve for not providing a faster rate of increase in money supply and for largely restricting its purchases and sales of government securities to "bills only." Specifically, the JEC majority would have the Federal Reserve Banks buy long-term Treasury bonds for the assorted purposes of enlarging the money supply, increasing Federal Reserve Bank profits, and making people more willing to buy bonds because they would know the Federal Reserve was standing ready to prevent excessive price declines.

There have been occasions when Federal Reserve policy has been unnecessarily restrictive as well as times when it has been excessively easy. But, on the whole, policies have been well directed. Restraint on credit availability and money supply has been vitally important in containing surges of inflationary pressure and checking the upward push in price levels. Creating more

money may seem a simple way to enlarge credit supply. But it risks setting inflation loose, intensifying credit demands, and raising interest costs even higher.

This has happened time and again in history. Trying to keep the inflationary balloon on an even course with escalator clauses on wages and bonds, as the French experience before the recent financial reforms suggests, simply makes conditions worse and creates distrust of bonds and even of government.

The JEC majority would have the Federal Reserve enlarge and lengthen its government security portfolio by buying bonds in the open market. The Federal Reserve would buy bonds in recessions to increase the money supply, in prosperity to prevent bond prices from declining too fast. The report does not specify the conditions under which the Federal Reserve would sell. The emphasis on enlarging and lengthening the Federal Reserve portfolio means that the public would be holding fewer bonds and that their government security holdings would be more liquid and comparable to cash. This would reduce the amount of bonds in the hands of the public, the opposite of what needs to be done.

The JEC Report takes the position that Federal Reserve support for bonds would make the public more willing to hold bonds, the supply of which could be enlarged by the Treasury. This is theoretically possible though there is some contrary experience. In 1947-48 the Federal Reserve increased its holding of Treasury bonds from $1 billion to $11 billion, supporting prices of 2½ per cent bonds above par. This arrangement did not help the Treasury put out more bonds — none whatever were issued until 1952 and that was in an unsupported market. The advantage of the pegs was to the holder of Treasury bonds who used Federal Reserve support, not as a reason to buy, but as a way of breaking his money loose for more advantageous investments. The problem now is not to look around for sellers of long-term Treasury bonds. It is to find buyers for new issues. What this takes is a favorable market opportunity and choice of a rate that will appeal to enough investors to make an offering worthwhile.

Holding the Line on Rates

While advocating Federal Reserve stabilization of Treasury bond prices, the JEC majority asserted its wish to make it "absolutely clear that these reforms in no way include the pegging of the bond market." Nevertheless it is not a long step from support of government bonds, and advocating that the Treasury exploit its alleged monopolistic position as a borrower, to the idea that the Federal Government should use its power to reduce and stabilize interest rates on long-term government bonds. Speaking on the floor of the House January 28, Congressman Wright Patman of Texas advocated that we "hold the line on interest rates" and quoted the view of Professor John Kenneth Galbraith of Harvard that "a clear intention to hold rates stable" would do as much good as paying higher rates to make a market for long-term Treasury bonds. This was the general philosophy under the pegging practice which worked to contract, rather than enlarge, the market for long-term U.S. bonds.

Further along the same line, Congressman Clem Miller of California entered into the Congressional Record an article by Robert Lekachman from the February 1 issue of the *New Republic* which asserted that,

> . . . Congressional reluctance to raise the interest ceiling is a judgment that existing rates are higher than they should be for the welfare of the society. If this is so, then allowing the Treasury to sell long-term securities is the equivalent of giving the purchasers an undeserved bonus over the lifetime of the bonds.

The article went on to advocate higher taxes to accommodate more government spending as "essential to the rectification of the imbalance in our society between private affluence and public poverty." Underlying these thoughts would seem to be a nostalgic desire to get back to the "good old days" of cheap money when the Federal Government could count on the Federal Reserve Banks for unlimited funds and did not have to worry about where the money was coming from to finance any and all outlays. Yet these were the "bad old days" from the standpoint of people who trusted the future buying power of the dollar or had to eke out an existence on fixed pensions with living costs moving ever upward.

It is the background of inflation that makes the bond investor wary and raises interest costs.

A Situation of "Monopsony"

The Joint Economic Committee's Report, in urging more use of the auction technique of selling government securities, argues that this can make the government securities market more competitive and hence cheapen Treasury borrowing costs. On this point many experts would disagree though there might not be any harm in trying out, say, a sale of one-year Treasury certificates of indebtedness on a competitive auction basis.

But the advocacy of competition in the government securities market collides with quite an-

other line of thinking, namely, that the Federal Government, being such a large and frequent borrower, should exercise a monopolist's power and hold its borrowing costs down simply by refusing to pay more. Under the heading of "Imperfect Competition in the Government Bond Market," the JEC majority states:

> The borrowings of the Federal Government are of such large volume both in total and in comparison with the volume of bonds of corporations and of State and local governments that they help markedly to determine interest rates instead of merely conforming to the forces of competition and supply and demand as has so often been asserted by the Treasury.
>
> In economic language, the situation approaches monopsony or a market in which one buyer purchases such a large proportion of the supply that imperfect competition results.
>
> The facts are that in 1958, the Federal Government borrowed three-quarters of the funds in the long term market (excluding short term bills, mortgages, and consumer credit). . . .

To people in the business, any figures showing the U.S. Treasury as a dominant factor in the long-term market are hard to believe. The most striking facts of the capital market since World War II have been (a) the dominance of real estate mortgages and (b) the comparative abstinence of the Treasury from the long-term market even though it had a huge floating debt in need of funding into bonds. The Committee omits mortgage investments from its analysis and includes, as Treasury borrowings in the *long-term* market, sales of certificates of indebtedness due within one year and notes due in 1-5 years. Such short-intermediate borrowings totaled $46.9 billion during 1958, as the table below shows.

In the year 1958 the Treasury, taking advantage of cheap money and also facing some sizable bond maturities, did issue a considerable volume of bonds. These totaled $15.6 billion including the ill-starred 2⅝s due in 6 2/3 years which involved speculative buyers in such heavy losses.

The heavy losses suffered by investors and speculators in the 2⅝s, along with other less spectacular examples of government certificate, note, and bond issues going below par soon after issuance, cast doubt on the theory that the Treasury, in setting rates on such securities, has been giving anything away. It is true that some other issues have proved profitable to initial purchasers but there must be counterbalancing profits to warrant the underwriting risks assumed.

Bonds due in five to ten years have more of an intermediate than long-term character. In the fullest sense, long-term bonds would be those due beyond 20 years. Treasury issues which fulfill this criterion have been few and far between and modest in amount. As a matter of record, the Treasury has come to market with bonds due beyond 20 years only six times since 1946 — once in 1953, twice in 1955, twice in 1958, and once in 1959. Treasury issues of bonds due beyond 20 years were the largest in 1958 of any of the 14 postwar years. Even so they reached only $2.9 billion.

Gross Issues of Marketable U.S. Government Securities

(In Billions)

	1958	1959	1946-59
Bills (due within 1 yr.)	$ 97.2	$102.7	$1,044.2
Certificates (due within 1 yr.)	36.6	19.7	357.7
Notes (due in 1-5 yrs.)	10.8	26.7	178.4
Bonds due in 5-10 yrs.	12.7	—	44.3
due in 10-20 yrs.	—	0.6	2.0
due after 20 yrs.	2.9	0.9	9.2
Total	$159.7	$150.6	$1,685.8

A Trillion in Bills

Assuredly the U.S. Treasury is the best customer in the world for the engraver's art. But the big turnover of U.S. securities is a measure of dominance, not in the long-term but in the short-term market; it is a measure of the huge floating debt, requiring constant new issues to pay off the stream of maturities. Gross issues of U.S. marketable securities are running around $150 billion a year with $100 billion accounted for by Treasury bills alone. Since World War II, as the first table shows, issues of bills have exceeded a trillion dollars.

These bills, mostly 91-day issues, almost invariably have been sold, in the manner commended by the Committee, at competitive auction. The Treasury does not attempt to exercise monopolistic power to dictate rates to the market.

Though the total federal debt is bigger than at the end of World War II, the amount in long-term form has shrunk. The Treasury totally abstained from any new marketable bond issues for six years until 1952 when the outstanding amount in the hands of the public, $113 billion at the end of 1945, had dropped to $70 billion. Bonds in the hands of the public now stand at $77 billion of which $17 billion mature and will require refunding within the next 21 months. With the passage of time, outstanding bonds constantly move closer to maturity. The total of U.S. Treasury bonds due beyond 20 years in the hands of the public today amounts to no more than $7 billion.

As the foregoing table shows, the bulk of the bond issues have been in the 5-10 year maturity range, appealing more to banks than to life insurance companies, pension funds, and other long-term investors. Now, under lawful prohibition to pay any fraction above 4¼ per cent on

bonds, the Treasury is denied power to participate in any area of the bond market.

The second table shows how the $55 billion total issues of marketable U.S. bonds since 1946 have been dwarfed by mortgages and new corporate securities.

Gross New Issues in the Capital Market

(In Billions)

	1958	1959	1946-59
Marketable U.S. Bonds	$15.6	$ 1.5	$ 55.5
Mortgages*	27.4	32.4	279.0
State & Local Government Issues†	7.4	7.7	66.2
Corporate Bonds & Notes	9.7	7.3	95.0
Corporate Stocks (excl. invest. cos.)	3.1	3.3	36.2
Foreign, Internat'l., etc. Issues	1.1	.6	5.1
Total	$64.3	$52.8	$537.0

*The true totals for new mortgages are not available. The figures given cover the largest item, mortgage recordings of $20,000 or less on nonfarm properties.

†The state and local government statistics include some short-term borrowings which cannot be segregated.

If the figures are viewed on a net basis, as in the third table, the Treasury has not participated at all in the postwar capital market. Against the issuance of $55 billion marketable bonds, $91 billion have been retired for a reduction of $36 billion in total outstanding supply. In contrast, mortgagors have raised $156 billion net over these 14 years, corporations $84 billion on bond and stock issues, and state and local governments $45 billion.

Net New Issues in the Capital Market

(In Billions)

		1958	1959	1946-59
Marketable U.S. Bonds	Issued	$15.6	$ 1.5	$ 55.5
	Retired	14.2	0.2	91.2
	Net Change	+ 1.3	+ 1.4	— 35.7
Mortgages*		15.3	19.3	155.7
State & Local Government Issues†		5.7	6.1	45.1
Corporate Bonds & Notes		6.0	4.4	57.6
Corporate Stocks (excl. invest. cos.)		2.2	2.3	26.2
Total		$ 30.5	$ 33.5	$ 248.9

*The figure for mortgages is the increase in total mortgage indebtedness as published in the *Federal Reserve Bulletin* and the *Economic Report of the President*.

†The state and local government statistics include some short-term borrowings which cannot be segregated.

Lessons Learned

It is a pity that the Treasury did not put out more long-term bonds in earlier years when this might have been done at rates ranging from 2¾ to 4 per cent. Back in 1948 a group of distinguished citizens, forming a Committee on Public Debt Policy, pointed out how:

> A large floating debt imposes problems of refinancing, impairs flexibility in fiscal planning, and increases the danger of inflation. A substantial part of our floating debt should be paid off out of budget surpluses or funded as rapidly as markets can be found.

The wisdom of funding debt has had to be learned the hard way, out of experience of having to pay relatively high costs for short-term finance. In a free society the Treasury cannot dictate to people what rates of interest they shall accept on U.S. bonds. The problem that has to be faced is to find rates that have public appeal and, without trying to monopolize it, to gain and hold a place in the long-term investment market.

In this effort the dedicated men in the U.S. Treasury Department trying to handle the $290 billion federal debt management problem deserve the support not only of the banking and financial community but also of the great body of citizens interested in preserving the dollar as a reliable standard of value for the nation and the whole world.

Do Savings Respond to Interest Rates?

Carrying on the debate against "tight money," Senator William Proxmire of Wisconsin, in a speech February 3, challenged the view that higher interest rates lead people to save more. In support of his position, Senator Proxmire entered into the *Congressional Record* an article, "Savings Slowdown," from that morning's *Wall Street Journal*, citing estimates that personal saving declined from $23.5 billion in 1958 to $23.3 billion in 1959. This went to show, seemingly, that the rise in interest rates during 1959 had no stimulating effect on personal saving.

The personal saving figures mentioned are those of the Department of Commerce, with the fourth quarter of 1959 estimated by the President's Council of Economic Advisers. Senator Proxmire quoted the *Journal* as saying that the Commerce Department figures are "the best overall gage of savings." Professional statisticians, however, do not accept this description. The Department itself advises that the figures be "used with caution."

The figures are not direct estimates of personal saving; they are what is left over when estimated personal consumption expenditures are subtracted from estimated personal income after taxes. Thus, the residual personal saving figures become the repository of errors in these complex estimates. They are subject to radical revisions, from time to time, but even so never can be taken as positively correct. A year ago the estimate of personal saving for 1958 worked out to $19.9 billion. Now 1958 is put at $23.5 billion with further revisions in prospect as the Department, with additional data, refines its calculations of personal incomes and outlays.

The inadequacies of the Department of Commerce figures on aggregate personal saving were brought to the attention of the Congressional

Joint Economic Committee five years ago by a committee of statistical experts asked to review saving statistics. The experts specifically warned "unwary users" against treating the Commerce Department figures "as if they constituted a specific estimate of saving":

> Consideration should be given to abandoning calling the series "personal saving," and to using instead a more neutral description, possibly "difference between estimated disposable personal income and estimated personal expenditures." Even the new title could not prevent some users from treating the figures as if they constituted a specific estimate of saving, but would at least reduce the Department's responsibility for this interpretation of the figures, and probably would also act as a warning sign to unwary users.

The Better Approach

Even if the Commerce Department's personal savings data could be taken as correct, they would not prove what the Senator would like them to prove. Conceptually, the figures include repayments of debt as saving and borrowings as negative saving. This spoils the analysis from the standpoint of seeing how people as *savers* react to higher interest rates. What people do as *borrowers* is a separate matter.

The best way to measure the response of individuals' savings to interest rates is by examining directly the annual accumulation of interest-bearing claims, deposits with savings institutions, investments in government securities, etc. One of the surprising things in the banking business over the postwar period has been the responsiveness and sensitivity of savers to offered interest rates. Institutions advancing rates generally have seen immediate responses. In part, of course, their gains of funds have tended to be at the expense of other institutions which have been put under competitive pressure to raise rates also and spread the benefits of higher rates out among the tens of millions of individual savers.

To be sure, there was a measurable slowing of the growth of savings institutions in 1959 but this merely reinforces the case for the influence of high interest rates. For the slowing reflected competition from the increasingly attractive rates – ranging from 4½ to 5 per cent – being paid on U.S. Treasury notes, certificates and bills while typical savings account rates ranged from 2 to 4 per cent. In evaluating the slackened growth of savings institutions, it is necessary to take into account the estimated $7 billion increase in individuals' holdings of marketable U.S. Government securities during 1959. The offering of 5 per cent notes last October alone attracted 130,000 separate subscriptions, the largest number to any marketable Treasury issue since World War I, with more than 100,000 coming from individuals, mainly fully paid subscriptions for amounts of $25,000 or less.

It is not adequately recognized that ever since the bond market was unpegged in 1951, individuals have responded to sharp advances in Treasury yields by increasing their holdings of marketable U.S. securities. Conversely, they have reduced their holdings in periods of easy money when yields became unattractive. These reactions were brought out in a chart published in the April, 1959 issue of this *Letter*.

The Whole Picture

Senator Proxmire objects that increases in interest rates merely shift funds from one savings form to another and quotes "most savings executives" as doubting "that higher interest rates induce consumers as a group to save a larger percentage of their incomes." The way to test this thesis is to look at the record.

There is no question but that some of the $7 billion increase during 1959 in individual holdings of marketable U.S. securities represented shifts out of Savings bonds; individuals' holdings of Savings bonds were reduced about $1½ billion in 1959. Moreover, as noted earlier, some was at the expense of savings deposits, which grew at a slackened rate. Nevertheless, the evidence is that the total of individuals' savings in interest-bearing form increased markedly from 1958 to 1959. When we add up the major known items, using the best estimates now available, we get the following results:

Increase in Individuals' Savings in Interest-bearing Forms, 1958 - 1959

(In Billions)

	1958	1959*
Savings Bonds	$— 0.5	$—1.8
Other U.S. Securities	— 3.0	7.5†
State & Local Gov't. Securities	1.2	3.5†
Corporate Bonds and Notes	1.5	0.1‡
Savings and Time Deposits in:		
Mutual Savings Banks	2.3§	1.0§
Postal Savings System	— 0.2§	—0.2§
Commercial Banks	5.7¶	8.2¶
Shares in Savings & Loan Ass'ns. & Credit Unions	6.5	6.9
Subtotal	13.5	20.2
Private Insurance Reserves	5.3‖	5.3‖
Noninsured Pension Funds	2.8‖	3.4‖
Total	$ 21.5	$ 28.9

*Preliminary estimates.

†Derived from U.S. Treasury and Securities and Exchange Commission data published in the President's January 1960 *Economic Report.*

‡Increase is for January-September 1959.

§As reported in the *Federal Reserve Bulletin.*

¶This is a residual figure, for nine months in 1959, derived from the Securities and Exchange Commission figure for total Savings and Time deposits.

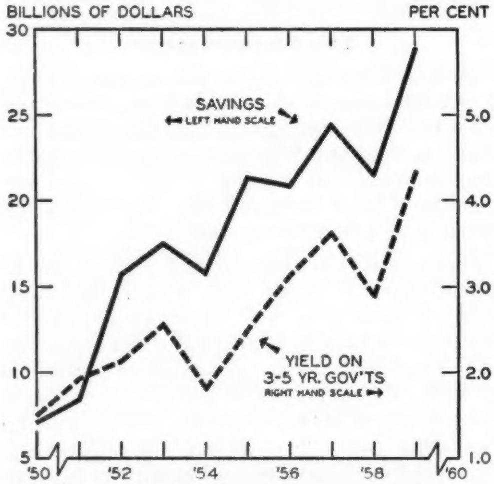
‖These increases include some acquisitions of common stock.

Sources: Securities and Exchange Commission for all figures except where otherwise noted.

It is apparent that, even though savings deposit growth was retarded, individuals responded

to higher returns not only by acquiring U.S. securities on a large scale but also by increasing their purchases of state and municipal bonds. Despite the competition of Treasury securities, savings and loan associations racked up a record year of growth, thus augmenting the supply of funds to finance home building.

The following chart shows the relationship, since 1950, between these individuals savings and yields offered on U.S. Government securities maturing in three to five years.



Increases in Individuals' Savings in Interest-bearing Forms* and Yields on Selected 3-5 Year Treasury Notes and Bonds, 1950-59

(Calendar year increases in savings, except that in 1959 increases in savings and time deposits and holdings of corporate bonds and notes are for nine months. Yields are calendar year averages.)

*Individuals' direct holdings of common stocks are excluded but the figures include common stock held by insurance companies and noninsured pension funds.

It is clear from the chart that individuals as savers do indeed react to changes in rates of interest offered. The most volatile item is holdings of marketable U.S. securities, which swing up and down with yields available in the market. Individuals lately have shown some interest in 5 or 5¼ per cent bonds of well-known companies.

Apparently, there are marginal decisions here and there, as rates improve, to put a little more money in interest-bearing investments. Interest itself is more likely to be saved than other types of income; it has to be if compound interest is to work to accumulate a nest egg.

Rising interest rates also can dampen inflationist sentiment in the stock market, as recent experience would seem to show. Higher rates on bonds directly invite switches from low-yielding stock investments. Willingness of government to restrict credit availability, and to meet the market and pay higher rates on its own borrowings, shows a firm resolve to encourage savings and discourage excessive spending, with effects of bolstering confidence in bond investments. The rush to acquire "inflation hedges" — really a run from money — dies down. Investments are made, as they should be, on intrinsic merit.

Influence of Credit Demands on Interest Rates

So long as the great mass of responsible, thrifty people trust the future value of money, rising interest rates bring a voluntary response of increased supply of loan funds to meet enlarged demands.

These increases in demands for borrowed money may come from government; they may come from business; or they may come from individuals as borrowers. Actually they come from all these sources but in different mixtures at different times. The sharp upswing in money rates that occurred in 1955, for example, stemmed in great measure from unprecedented demands by individuals for borrowed money to finance purchases of homes and cars. In 1956 and 1957 increased business demands for credit, to finance plant and equipment outlays, assumed greater importance. Last year it was the huge federal deficit, joined by expanded credit demands from almost every other direction, that pushed interest rates upward so rapidly.

The importance of rebalancing the federal budget is that this can ease tensions in the money and capital markets and leave more credit available for other uses: for business, large and small, for local governments, for construction. Perhaps it can lead to income tax rate reforms, enhancing abilities to save.

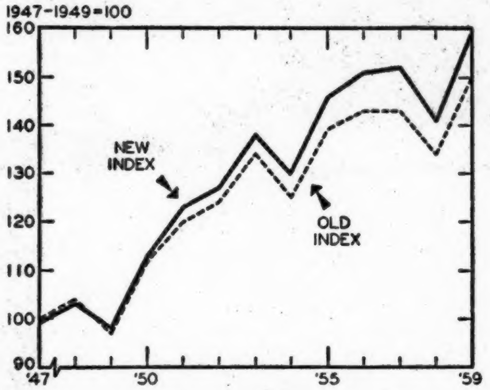
It is clearly not the case that people do not care what rates of return they get on their money. Still capitalists at heart, they aspire to some resources beyond pensions and benefits provided by government and employers. They react in reasonable ways to market opportunities and in so doing sustain a capital market that can finance each year so many new homes, schools, roads and bridges, so much new expansion of telephone, electric power, and industrial plant. This money builds the reality of national wealth. As we grow into the Sixties we will need more savings and savers. We will need to offer rates people accept as adequate and attractive.

New Yardstick of Industrial Growth

The nation's industrial growth in recent years has been even faster than most people believed, according to revised data released by the Federal Reserve Board. The Board's index of industrial production, long one of the most wide-

ly used economic indicators, has been revised, expanded, and regrouped to make it more up-to-date and even more useful than before. With 1947-49=100, the new index averaged 159 during 1959, approximately ten points, or 7 per cent, higher than the old one.

The Board's index, first published in 1927, previously had covered manufacturing and mining activity only. As revised in 1953, the index had shown, for the postwar 1947-59 period, an average annual growth of 3.4 per cent compounded. The new index, presented in the *Federal Reserve Bulletin* for December 1959, and embracing for the first time the rapidly growing output of electric and gas utilities, had a 1947-59 average growth rate of 4.1 per cent per year. The chart shows the movements since 1947 of the old index of industrial production and the new index as redefined to include electric and gas utilities.



Comparison of Old and New Federal Reserve Indexes of Industrial Production

The new figures will require some recalculations of the "lagging economic growth" of which so many complaints have been heard. In an economy such as ours, in which innovation and technological change play such a prominent part, many statistics unavoidably lag behind the actual rate of progress. While indexes can measure with reasonable accuracy the output of previously existing products or industries, they often do not give adequate weight to new and rapidly expanding types of activity.

Nature of the Revision

Part of the reason for the revision was to catch up with errors of this type which had been cumulating since the previous overhaul of the index in 1953. The following summarizes some of the main features of the revision:

1. Monthly data in the new index have been adjusted to levels indicated by annual Census surveys through 1957 as well as the 1954 Census of Manufactures. The previous index was tied primarily to data from the 1947 Census of Manufactures, and had last been adjusted to annual benchmarks for the year 1952.

2. Several new monthly series have been developed and existing ones refined. Part of the upward revision reflects greater actual growth in output per man-hour than was previously assumed.

3. For the period January 1953 to date, the weights by which individual industry indexes are combined into subgroups and totals are now related to the year 1957 – a more up-to-date and appropriate basis for determining such relationships between industries than the 1947 weights used in the old index.

4. The inclusion of electric and gas utilities, which accounts for about one third of the current difference between the old and new indexes, provides more complete coverage of power and fuel ouput; coal and oil were already included in the old index. This also makes the index more comparable with those published by leading foreign countries.

5. The Board is continuing to publish its major indexes on a 1947-49=100 base as before, to provide comparability with the many other economic indicators still using that base. However, to facilitate analysis of production changes in relation to a more recent period, the detailed breakdown by industries and market groupings is being presented on a 1957=100 base.

6. A major accomplishment in this revision is the development of market groupings of output series in addition to the industrial breakdown previously published. The new measures of consumer goods, business and defense equipment, and materials will greatly aid analysis of inventory developments, shifts in demand, and business cycle fluctuations.

This revision has not only tilted the growth trend of industrial activity more decisively upward; it has also changed the contours of some recent business cycles. The new index shows somewhat greater drops in the 1953-54 and 1957-58 recessions, but a slightly lesser decline in the 1948-49 dip. Thus, the new index gives a picture of successive deepening of the three postwar recessions. From cyclical peak to trough, the decline figures out at 8 per cent in 1948-49, 10 per cent in 1953-54, and 14 per cent in 1957-58.

The greater timeliness and flexibility of these new measures of industrial activity should make them even more useful tools for business analysis and policy determination.

,"

free
olio.
City
nual
plete
own,
vest-
men-
fice.
ORK
U.S.A.